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United States of America

In the

Supreme Court of the United States

October Term, 1950

No. 262

CHARLES A. CAROLIN,
Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE,
Respondent

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT AND BRIEF IN SUPPORT THEREOF

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INDEX

	Page
Petition for a Writ of Certiorari	1-6
Statement of Matters Involved	2-3
Basis of this Court's Jurisdiction	3
Questions Presented	3-4
Reasons Relied on for Allowance of the Writ	4-6
Brief in Support of Petition	7-14
I. Opinion Below	7
II. Jurisdiction	8
III. Statement of the Case	8
IV. Errors Relied On	8-9
V. Argument	9-13
VI. Conclusion	13-14
Appendix	15-16

CASES CITED

Bodden, R. K. v. Commissioner, (C. A. 5th) 50-1 U. S. T. C. 9341	5
Commissioner v. Culbertson, 337 U. S. 733	2, 9
Commissioner v. Tower, 327 U. S., 280	2, 9
Ginsburg v. Commissioner, (C. A. 5th), 176 Fed. (2) 879; rehearing 176 Fed. (2) 884	4-5
Harris, Anna, v. Commissioner, (C. A. 9th), 175 Fed. (2) 444	4
Lusthaus v. Commissioner, 327 U. S. 293	2, 9
Miller, Sam H. v. Commissioner, (C. A. 6th) 50-1 U. S. T. C. 9327	10-11

Page

Seabrook, L. W. v. Commissioner, (C. A. 5th) 176 Fed. (2) 605 4
Trepte, Walter v. Commissioner, (C. A. 9th), 175 Fed. (2) 444 4
Tomlinson, Elwyn White, v. Commissioner, (C. A. 5th), 50-2 U. S. T. C. 9354..... 5

STATUTES AND RULES CITED

26 U. S. C. 1141(a) and (c) (1)..... 3
28 U. S. C. 1254 (1)..... 3
Federal Court Rule 52-(a)..... 13

TEXTS CITED

Current Income Tax Aspects of Family Partnerships, T. V. Monahan, 36 Virginia Law Review, April 1950 14

APPENDIX

26 U. S. C. 1141(a); (c) (1)..... 15
28 U. S. C. 1254 (1)..... 16
5 U. S. C. 1009 (e)..... 15

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To the Honorable, The Chief Justice and Associate Justices of The Supreme Court of the United States:

Your Petitioner, Charles A. Carolin, respectfully represents as follows:

STATEMENT OF MATTERS INVOLVED

Petitioner seeks to bring before this Court a decision of the United States Court of Appeals for the Sixth Circuit, affirming a Tax Court decision disallowing a family partnership. The partnership was between petitioner and his wife, Helen E. Carolin. The case was submitted to the Tax Court prior to the decision of this Court in *Commissioner v. Culbertson,* 337 U. S. 733. The validity of the family partnership was decided and the facts were determined without benefit of that decision. The Tax Court applied sole tests of "vital services" and "original capital" and held the partnership to be invalid for income tax purposes. It failed to make any finding as to whether or not petitioner and his wife in good faith and acting with a business purpose intended to join in the conduct of the enterprise as partners. The word "intent" is nowhere mentioned in the Tax Court's opinion (R. 111-24).

The Tax Court decision was rendered June 1, 1949. On June 27, 1949, this Court rendered its decision in the *Culbertson* case. This Court, in the *Culbertson* case, was concerned with a similar Tax Court decision disallowing a family partnership without making any findngs as to the intention of the parties to join together as partners. Certiorari was granted to consider the Commissioner's claim that the principles of *Commissioner v. Tower,* 327 U. S. 280 and *Lusthaus v. Commissioner,* 327 U. S. 293 had been departed from by the Courts of Appeals. This Court held that the Tax Court had erroneously construed the Tower and Lusthaus decisions as setting out tests of "vital services" and "original capital" in determining the validity of the family partnership. Having failed to make any finding as to the intention of the parties to

join together as partners, the true test of a valid family partnership, the cause was remanded to the Tax Court for such findings.

On July 18, 1949, petitioner filed a motion for leave to file a motion for reconsideration out of time which the Tax Court denied (R. 2). The decision was appealed to the Court of Appeals below wherein petitioner urged in his brief that the case should be remanded to the Tax Court for further proceeding in conformity with the *Culbertson* case. The Court of Appeals below affirmed the Tax Court *per curiam* (R. 131). Petition for rehearing was filed, again alleging that the case should have been remanded to the Tax Court for further proceedings in conformity with the holding in the *Culbertson* decision (R. 133-5). This petition was denied (R. 136).

BASIS OF THIS COURT'S JURISDICTION

Petitioner contends that this Court has jurisdiction to review the judgment here in question under the provisions of *26 U.S.C. 1141 (a) and (c) (1) and 28 U.S.C. 1254 (1),* (Appendix), and that the facts hereinbefore and hereinafter in this petition set forth bring the case within the statutes cited; *Commissioner v. Culbertson, supra.* The Court of Appeals decision was rendered April 19, 1950 and timely petition for rehearing denied June 1, 1950.

QUESTION PRESENTED

Where, in a family partnership case, the Tax Court applying sole tests of "vital services" and "original capital", and determines that the partnership is not valid for

income tax purposes and makes no finding as to the intent of the parties to join together as partners, should the Court of Appeals on review of such decision remand the case to the Tax Court for determination of the question of intent in conformity with the *Culbertson* case?

The Court of Appeals answered this question in the negative.

REASONS RELIED ON FOR ALLOWANCE OF WRIT

1. The decisions of the Tax Court and Court of Appeals below are contrary to the decision of this Court in the *Culbertson* case. The intent of the parties determines partnership status; not arbitrary tests of "vital services" or "original capital." It is the duty of the Tax Court to determine whether or not the parties in good faith intended to join together as partners. This Court has held that where there is not even an oblique reference to intent in a Tax Court decision, the case must be remanded to the Tax Court for determination of such intent, *Culbertson, supra,* (P. 748).

2. The decision of the Court of Appeals below conflicts with decisions of the Court of Appeals for the Fifth and Ninth Circuits. The Court of Appeals for the Ninth Circuit in two family partnership cases immediately subsequent to the Culbertson decision, *Walter Trepte v. Commissioner,* 175 Fed. (2) 444 (July 13, 1949) and *Anna Harris v. Commissioner,* 175 Fed. (2) 444, (July 13, 1949) reversed the Tax Court and remanded the cases for further proceedings in conformity with the Culbertson decision. The Fifth Circuit did likewise in *L. W. Seabrook v. Commissioner,* 176 Fed. (2) 605, (August 2, 1949) and in *Ginsburg v. Commissioner,* 176 Fed. (2) 879, (August

16, 1949) affirmed a District Court decision disallowing a family partnership case but on petition for rehearing vacated its judgment and reversed and remanded the cause to the District Court, 176 Fed. (2) 884, (September 13, 1949), to conform to its decision in the *Seabrook* case. The Fifth Circuit has subsequently in *R. K. Bodden v. Commissioner,* 50-1 USTC 9341, (June 9, 1950) and *Elwyn White Tomlinson, et al, v. Commissioner,* 50-2 USTC 9354; apparently on its own motion, remanded the cases to the Tax Court for further proceedings in conformity with the *Culbertson* case *prior to considering the appeal.* These were not reversals on the merits.

3. The administration of the Federal Income Tax law is a matter of public interest. Decision by this Court is necessary to remove the confusion that exists between the Courts of Appeal for the Fifth and Ninth Circuits on one hand and the Sixth Circuit on the other, in appeals to those circuits in family partnership cases. Harmony of decisions among the various Courts of Appeal is necessary for uniformity in the administration of the Federal Income Tax law.

The question involved is substantial. It affects the administration of the federal income tax laws. It concerns unanimity of procedure by the Courts of Appeal in family partnership cases. It involves the fundamental right of petitioner to a trial of the facts in this case and conclusions to be drawn therefrom upon proper legal criteria, without which petitioner is deprived of his day in court. Substantial sums are involved, deficiency having been assessed against petitioner of $15,371.06 for the calendar year of 1943 and $17,317.66 for the calendar year 1944 (R. 7).

Wherefore, Petitioner respectfully prays that a Writ of Certiorari be issued out of and under the seal of this Court directed to the United States Court of Appeals for the Sixth Circuit that this cause may be reviewed and determined by this Court, as provided by law, and that Petitioner may have such other and further relief or remedy in the premises as to this Court may seem appropriate and that judgment of said Court of Appeals may be reversed.

CHARLES A. CAROLIN,
Petitioner,

By WILLIAM A. ALFS,
(Donald K. Tyler, *Of Counsel),*
Attorneys for Petitioner.

United States of America

In the

Supreme Court of the United States

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No.

CHARLES A. CAROLIN,
Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE,
Respondent

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

I.

OPINION BELOW

The official report of the decision below (R. 131) is reported at 181 Fed. (2) 186. The findings of fact and opinion of the Tax Court (R. 111-24) are reported at 8 TCM. 548.

II.

JURISDICTION

1. The judgment to be reviewed is dated April 19, 1950 (R. 131). Timely petition for rehearing was denied June 1, 1950 (R. 136).

2. Statutory provisions and facts upon which this Court has jurisdiction are set forth in the petition for certiorari under captions "Statement of Matters Involved", "Basis for this Court's Jurisdiction" and Reasons Relied on for Allowance of the Writ."

III.

STATEMENT OF THE CASE

A statement of the facts as presented to the Tax Court are not necessary for a determination of the issue presented by this petition. The facts pertinent to the issue presented by this petition are set forth in the Petition for Certiorari under caption "Statement of Matters Involved."

IV.

ERRORS RELIED ON

1. That the Court of Appeals below erred in affirming the decision of the Tax Court.

2. That the Court of Appeals below erred in not remanding the case to the Tax Court for further proceedings in conformity with *Commissioner v. Culbertson*, 337 U. S. 733.

V.

ARGUMENT

For a period of three years subsequent to this Court's decision in *Commissioner v. Tower*, 327 U. S. 280 and *Lusthaus v. Commissioner*, 327 U. S. 293, it was the mistaken belief of the Tax Court, Court of Appeals, the Treasury and the bar that "vital services" and "original capital" were the decisive tests in the determination of whether or not a valid family partnership existed for tax purposes. It was in this atmosphere of mistaken belief that the Commissioner in the original instance disallowed the family partnership, (R. 10) and the case subsequently tried before the Tax Court with the resultant disallowance of the family partnership, (R. 119-23). No determination was made by the Tax Court as to any lack of bona fide intent on the part of petitioner and his wife that they be partners in the conduct of the foundry business, the Tax Court merely holding that Helen E. Carolin's services were not vital and that she contributed no capital originating with her. Within less than a month after the Tax Court's decision, this Court rendered its decision in *Commissioner v. Culbertson*, 337 U. S. 733, wherein this Court held it erroneous for the Tax Court to use sole test of "vital services" or "original capital" as essential to the validity of a family partnership. This Court said: "Not once in its [Tax Court] opinion is there even an oblique reference to any lack of intent on the part of respondent and his

sons to combine their capital and services "for the purpose of carrying on the business," (p. 743), and further stated that "The cause must therefore be remanded to the Tax Court * * *", (p. 748). No attempt was made by this Court to pass upon the facts of the case, for, as Mr. Justice Frankfurter stated in his concurring opinion, "It [Supreme Court] remands the case to the Tax Court because it is for that Court, and not for the Court of Appeals, to ascertain, on the basis of appropriate legal criteria, the existence of a partnership within the provisions of Internal Revenue Code Sec. 181 and 182 * * *" (p. 749).

The Tax Court in the first instance should have entered an order for retrial of the case when the *Culbertson* decision was brought to its attention and in failing to do so, the Court of Appeals should have done so. Mr. Justice Frankfurter in his concurring opinion in the *Culbertson* case stated (P. 752):

> "* * * Therefore, a finding by the Tax Court that that which has the outward appearance of an arrangement to engage in a common enterprise is not in fact such an associated business venture ought to be respected when challenged in another court, unless such a determination is wholly without warrant in fact, *or, as in the case, the wrong standards for judgment have been applied.*" (Italics supplied.)

That the Tax Court and Court of appeals below applied the wrong standards for judgment, "vital services" and "original capital", is evident from the reported syllabus to the decision of the Court of Appeals, in our case, 50-1 U. S. T. C. 9327:

> "Family partnerships: Inadequate services and contributions of capital: Evidence—The taxpayer

and his wife were not valid partners in the conduct of a foundry business, where it was found that the wife's contribution did not *originate with her* and that services rendered by her, consisting of clerical work in the evenings and on week-ends, *were not vital.*" (Italics supplied.)

The day following the denial of petitioner's petition for rehearing, the Court of Appeals below reversed a Tax Court decision disallowing a family partnership with full opinion, *Sam H. Miller v. Commissioner*, 50-1 U. S. T. C. 9327, and remanded the case to the Tax Court, in which we find the following language:

"Substantial evidence is such relevant evidence as a reasonable mind might accept as adequate to support a conclusion, *Consolidated Edison Co., et al. v. National Labor Relations Board, et al.*, 305 U. S. 197. It was, however, not upon substantial evidence of the intention of the parties that the case was decided, but upon the basis of certain 'tests' * * *. Nowhere is found any conclusions as to whether or not the Millers in good faith and acting with a business purpose intend to join in the conduct of the enterprise—the true test of a valid family partnership * * *."

* * * * *

"Counsel for respondent argue in their brief that the Tax Court found there was no evidence of any real intention to make the children partners in the business. This is incorrect. The Tax Court made no findings as to intention with respect to the trusts. * * *

* * * * *

"Counsel for respondent submit that * * * it could be reasonably considered that the benefits in the trust, directly or indirectly retained by the petitioner and his wife blended imperceptibly with the

> normal concepts of full ownership, and that, therefore, the transfer to the children of real partnership interests was not intended. The argument is persuasive, *but in the absence of findings on this proposition, it will be necessary to remand the case as in Culbertson v. Commissioner, supra.*" (Italics supplied.)

It is significant that the bench was composed of Judges Hicks, Allen and McAllister in our case and Judges Martin, McAllister and Miller in the *Miller* case, indicating a division of thinking within the Court of Appeals below on the question before this court.

The fact that the Commissioner has not sought certiorari in the decisions of the Fifth and Ninth Circuits remanding family partnership cases to the Tax Court indicates a concurrence with the decisions of those courts that, in family partnership cases wherein the Tax Court has made no findings as to the intention of the parties, the cases should be remanded to the Tax Court.

We believe the language of the Fifth Circuit in *R. K. Bodden, supra,* expresses the proper procedure to be followed in cases such as the one at bar:

> "We are of the opinion that before considering the petition for review of the Tax Court's decision in this case, we should have the benefit of its re-examination of the questions and its re-determination of the facts in the light of the opinion in the *Culbertson* case.
>
> "We, therefore, order a remand of this cause to the Tax Court for further proceedings in conformity with the opinion of the Supreme Court in the Culbertson case with the right in either of the parties to offer such further or additional positions as may be appropriate in the light of that opinion."

An examination of the Tax Court opinion in that case, 8 T. C. M. 243, indicates that the Tax Court passed directly on the question of intent of the parties, nevertheless the Fifth Circuit remanded and, at the time of writing this brief, certiorari has not been authorized by the Commissioner.

CONCLUSION

Petitioner does not seek, by this petition, to have this Court pass upon the factual pattern of this case. That is for the trial court. Petitioner does seek the right to present that factual pattern and have proper findings thereof and conclusions drawn therefrom by the trial court. This Court's decision in the *Culbertson* case was so new and its far reaching implications not fully apparent when petitioner asked the Tax Court to reconsider its decision. But by the time this case reached the Court of Appeals below, two other Courts of Appeal had spoken on the subject, the Fifth and Ninth, and these circuits construed this Court's opinion in the *Culbertson* case to impose a duty on the appellate court to remand to the Tax Court family partnership cases decided without the benefit of the *Culbertson* decision. The Court of Appeals below has taken a contrary view in our case. The Commissioner, by his failure to apply for certiorari in the Fifth and Ninth Circuit decisions, has concurred in the procedure there followed.

Unless this Court exercises its power to review the decision below, a serious injustice will be sustained by petitioner. Without the benefit of the words of this Court in the *Culbertson* case the Tax Court did not properly find facts and conclusions of law required of it under Federal Court Rule 52 (a). Had the *Culbertson* decision

been before that Court, a different result might have occurred.[1]

Petitioner being a resident within the jurisdiction of the Court of Appeals below finds himself without the right of a retrial because that Court did not construe the *Culbertson* decision as obligatory to remanding family partnership cases of this nature whereas two other Courts of Appeal do. Petitioner suffers the further misfortune that the Court of Appeals below is of itself divided on this question. Where a federal law is involved its administration should be carried out harmoniously not only between the various Courts of Appeal but within each circuit also. To deny the writ prayed for will make petitioner the victim of his residence and the chance of the judges who sit on the day of the hearing of the appeal below.

We respectfully submit, that for the reasons above stated, the Writ of Certiorari should be granted as prayed for.

Respectfully submitted,

WILLIAM A. ALFS,
(Donald K. Tyler, Of Counsel)
Attorneys for Petitioner.

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[1] See *Current Income Tax Aspects of Family Partnerships—T. V. Monahan, 36 Virginia Law Review,* April 1950, where this observation is made (p. 370):

> "The opinions of the lower courts since the Culbertson decision have shown that the latter by and large has been interpreted favorable to the taxpayer. The disclaimer of 'vital services' and 'contribution of outside capital' as indispensable ingredients of a valid family partnership has resulted in recognition being granted to a greater number of such partnerships in cases where a valid intent to transfer the economic factors actually producing the income has been shown. * * *".

APPENDIX

5 U. S. C. Sec. 1009 (e):

> "So far as necessary to decision and where presented the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of any agency action. It shall (A) compel agency action unlawfully withheld or unreasonably delayed; and (B) hold unlawful and set aside agency action, findings, and conclusions found to be (1) arbitrary, capricious, and abuse of discretion, or otherwise not in accordance with law; (2) contrary to constitutional right, power, privilege, or immunity; (3) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right; (4) without observance of procedure required by law; (5) unsupported by substantial evidence in any case subject to the requirements of sections 1006 and 1007 of this title or otherwise reviewed on the record of an agency hearing provided by statute; or (6) unwarranted by the facts to the extent that the facts are subject to trial *de novo* by the reviewing court. In making the foregoing determinations the court shall review the whole record or such portions thereof as may be cited by any party, and due account shall be taken of the rule of prejudicial error."

* * * * *

INT. REV. CODE, Sec. 1141:

> "(a) Jurisdiction.—The courts of appeals shall have exclusive jurisdiction to review the decisions of the Tax Court, except as provided in section 1254 of title 28 of the United States Code, in the same manner and to the same extent as decisions of the district courts in Civil actions tried without a jury; and the judgment of any such court shall be final, except that it shall be subject to review by the

Supreme Court of the United States upon certiorari, in the manner provided in section 1254 of title 28 of the United States Code."

"(c)(1) Upon such review, such courts shall have power to affirm, or, if the decision of the Tax Court is not in accordance with law, to modify or reverse the decision of the Tax Court, with or without remanding the case for a rehearing as Justice may require."

28 U. S. C. Sec. 1254:

"Cases in the courts of appeals may be reviewed by the Supreme Court by the following methods:

'(1) By writ of certiorari granted upon the petition of any party to any civil or criminal case, before or after rendition of judgment or decree; * * *.'"

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute involved	2
Statement	2
Argument	13
Conclusion	15

CITATIONS

Cases:

Commissioner v. *Culbertson*, 337 U. S. 733	13, 15
Commissioner v. *Tower*, 327 U. S. 280	13
Lusthaus v. *Commissioner*, 327 U. S. 293	13

Statute:

Internal Revenue Code, Sec. 22 (26 U.S.C. 1946 ed., Sec. 22)	2

In the Supreme Court of the United States

OCTOBER TERM, 1950

No. 262

CHARLES A. CAROLIN, PETITIONER

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COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 111-124) are not officially reported. The *per curiam* opinion of the Court of Appeals (R. 131) is reported at 181 F. 2d 186.

JURISDICTION

The judgment of the Court of Appeals was entered on April 19, 1950 (R. 131), and a petition for rehearing was denied on June 1, 1950 (R. 136). The petition for a writ of certiorari was filed on August 23, 1950. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

Whether the Court of Appeals erred in failing to remand the case to the Tax Court in order that the latter should reconsider in the light of the *Culbertson* decision its finding on the entire record that no real partnership existed between taxpayer and his wife during the tax years in question.

STATUTE INVOLVED

Internal Revenue Code:

> SEC. 22. GROSS INCOME.
>
> (a) [as amended by Section 1 of the Public Salary Tax Act of 1939, c. 59, 53 Stat. 574] *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *
>
> * * * * *
>
> (26 U. S. C. 1946 ed., Sec. 22.)

STATEMENT

The material facts as found by the Tax Court (R. 111-119) are as follows:

The taxpayer's father, Robert E. Carolin, began

a small iron foundry in Detroit about 1912. During the first World War his business increased in size, and at times he employed as many as twenty men. After 1918, however, it began to decline. For lack of orders and modern equipment it was very unproductive by 1933, and Carolin was in financial straits. By 1937 he had only one employee and his shop was in serious need of repair. To provide $50 a week for the maintenance of himself, wife and family, he had allowed taxes to fall in arrears and had borrowed money, using his home and insurance policies as collateral. He died suddenly on November 20, 1937, leaving his widow and nine children surviving. The taxpayer then 22, was next to the youngest. Robert B. Carolin left assets valued at about $23,000, of which about $12,000 was attributed to the foundry. He owed about $3,500 in debts and taxes. (R. 111-112.)

The taxpayer was then living at his parents' home and was employed as a soap salesman. His fiancee was working as a stenographer at a salary of $1,250 a year. His mother, much worried about financial matters and wishing to continue her husband's business, urged him to give up his job and work at the foundry. The taxpayer and his fiancee agreed to postpone marriage in order to comply with his mother's request, and he started work at the foundry for $30 a week shortly afterwards. As the widow inherited one-third of her deceased husband's estate and each of the nine children two twenty-sevenths, the taxpayer ob-

tained a promise from her that she would get all the children to assign their interests in the foundry to her. His fiancee had insisted on this arrangement, promising to keep her job and to help the taxpayer with the foundry work if the business was protected against future claims of his brothers and sisters. With his fiancee's approval he later declined a favorable offer of employment to continue his work at the foundry. (R. 112.)

The mother's settlement with the children was beset with difficulties, but on November 12, 1938, or a few weeks after entry of an order of the probate court fixing the heirs' shares, eight of the children gave her a quit-claim deed of their interests in the foundry. The ninth child did likewise on August 21, 1941. The taxpayer received nothing as consideration for the quit-claim deed he gave, but three of his brothers demanded and obtained notes. A bill of sale covering the personalty was also executed, and on December 9, 1938, the widow filed with the clerk of Wayne County, Michigan, a certificate of conducting business under the assumed name of R. B. Carolin Foundry. Prior to this time, on September 17, 1938, the taxpayer and his fiancee were married and thereafter resided at his mother's home, where the three often discussed business matters and reached decisions. Among these was a major decision to accept a contract for certain work from Clayton & Lambert Company in January, 1939. This contract proved to be very profitable, but in the condition of the business at

the time considerable risk was involved. (R. 112-113.)

To revive the enterprise, the taxpayer devoted long hours to work, and used his own car for business purposes without receiving extra payment therefor. His wife helped him in clerical matters at the shop on Saturdays and Sundays and sometimes handled correspondence at home on evenings of other days. Although some progress was being made, the need for repairs entailed so much expense that no surplus funds accumulated, and he and his wife were discouraged by the prospects. At his wife's urging he requested of his mother some recognition of a proprietary interest if he was to continue, and on July 29, 1939, his mother and he signed an agreement to conduct the business as partners under the name of R. B. Carolin Foundry. They recited in the agreement that the mother had contributed her interest in machinery, equipment and good will as capital and that the taxpayer had contributed his interest in the same property and was to contribute further his skill and experience. They agreed that each share equally in profits and losses; that the taxpayer devote his undivided time and attention as manager and receive compensation therefor; that the partnership assume all debts and liabilities of the business; that the real estate constituting its premises remain the property of the mother and be rented to the partnership, and that the partnership be continued (unless previously dissolved by mutual consent) after the death of

either partner, each agreeing to bequeath to the other one-ninth of his interest and reserving the right to dispose of the rest by will. The last provision was intended to insure control of the survivor. A certificate that the taxpayer and his mother were conducting the business as partners was promptly filed with the county clerk. The taxpayer continued to manage the enterprise as before and his wife, who kept her stenographic position until early in 1941, rendered assistance as before until late in 1940. In lieu of paying rent for the premises to the mother, the partnership paid taxes on them, including arrears. (R. 113-114.)

Early in 1941 the partnership, after expanding its activities, employed an accountant who, in discussing problems with the taxpayer, suggested incorporation as a better means of protecting the taxpayer against possible difficulties with his brothers and sisters after his mother's death. The mother was agreeable; the partnership was formally dissolved, and on October 1, 1941, the R. B. Carolin Foundry & Machine Company was organized as a Michigan corporation with a paid-in capital of $10,000, represented by 10,000 $1 par value shares, of which the taxpayer subscribed for 5,000 and his mother for 5,000. They and a third person were named directors. The partnership's assets (except cash) and liabilities were taken over by the corporation, which immediately issued a certificate for 4,500 shares to "Charles A. Carolin and Helen Carolin"; a certificate for a like number to

the taxpayer's mother, and a certificate for 1,000 shares to "Charles A. Carolin and Louise W. Carolin, Joint Owners with right of survivorship." The taxpayer became president and treasurer, and his mother secretary, with a salary of $200 a month. On October 1, 1941, the mother leased the business premises to the corporation for $200 a month or two percent of gross sales, whichever was greater. (R. 114-115.)

By this time the foundry had fifty employees, the manufacture of screw machine products was begun, contracts for airplane wing sections had been obtained from the Chrysler Corporation, and numerous used machines were being bought, rebuilt, and added to the plant's equipment. Business increased enormously with orders for military requirements, and on its income tax return for the first fiscal year ended September 30, 1942, the corporation reported gross sales of $387,996.10, gross profits of $149,321.20, and a net income of $74,081.84. There were no distributions to stockholders, but $24,808.71 was paid to the taxpayer as salary; $200 a month to his mother as salary and $6,808.71 as rent. An RFC loan of $140,000 was procured and repaid. Before the end of 1942 renegotiation of the war contracts started, and deduction of the amounts paid to the mother were challenged in the computation of profits and were ultimately disallowed. (R. 115.)

After consulting an attorney who specialized in tax matters, the taxpayer and his mother, as stock-

holders representing all outstanding shares, resolved on March 11, 1943, that (R. 115):

> (I) The Corporation sell to a co-partnership to be formed by Mr. Charles A. Carolin, Mrs. Louise W. Carolin and Mrs. Helen E. Carolin, all of the unfilled contracts and purchase orders on hand, all the inventory of raw material and work in process, both in the foundry and in the machine shop and all of the cash in the National Bank of Detroit in an amount of approximately $10,000.00 and all sums due from employees.

The recited consideration was $3,000 payable by the partners, the proposed partnership note for $14,500 and its assumption of listed corporate obligations. On July 1, 1943, "but as of April 1, 1943", the taxpayer, his mother and his wife signed articles of co-partnership to conduct a machine shop and foundry business under the name of R. B. Carolin Foundry & Machine Company. Contribution of 50 percent of the capital by the taxpayer, 25 percent by his wife and 25 percent by his mother was recited, and the profits were to be distributed 40 percent to the taxpayer, 40 percent to his mother and 20 percent to his wife. Each of the three agreed "to devote so much of his time, skill and energy necessary to the best interests" of the partnership; correct records were to be kept, and partnership funds were to be deposited in a bank account subject to withdrawal by one of the partners or by an authorized agent. A certificate of

copartnership was signed and filed by the three on June 21, 1943, with the county clerk. The corporation, however, was not dissolved, but its name was changed to The Carolin Manufacturing Corporation. It retained the lease from the mother on the business premises, and immediately subleased them to the partnership for $1,000 a month; it also retained machinery and equipment which it leased to the partnership, and it held the partnership's $14,500 note. (R. 115-116.)

By bill of sale dated July 1, 1943, "but as of April 1, 1943," the corporation transferred to the new partnership all assets described in the stockholders' resolution, and the partnership gave to the corporation its demand note for $14,500, dated March 31, 1943. Entries as of the latter date were made on the corporate books to reflect a transfer of assets, having a book value of $42,078.37, comprising raw materials, work in process, cash of $10,930.75, and contracts for $290,662.80 of work, entered as an asset at $14,531.14. By entries of the same date liabilities aggregating $24,907.47 were eliminated, comprising $12,869.80 due the taxpayer for salary. The opening entries on the partnership's books indicated assets of $42,078.37, transferred by the corporation, and a note receivable of $1,335.45 due from the taxpayer's wife, or a total of $43,413.82. The listed liabilities of like amount comprised "invested capital" of $2,670.90, representing a transferred note due the corpora-

tion from the taxpayer's mother, $1,335.45, representing a note in that amount given the partnership by the taxpayer's wife, and $1,335.45, representing a part of the salary due the taxpayer by the corporation. The remainder due him, or $11,534.35 appeared also as a liability of the partnership. The taxpayer's wife paid her note by a check drawn against a joint bank account in the names of the taxpayer and herself. (R. 116-117.)

Early in 1941 the taxpayer purchased a residence in the joint names of himself and wife for $9,400, and they ceased to live with his mother. His wife continued to discuss business affairs with him at home; their personal relations were close, and he was appreciative of her encouragement and assistance in clerical work at the foundry from 1938 to the latter part of 1940. From her own savings she had given him $260 for house furnishings prior to their marriage; she contributed $350 in July, 1939, to the purchase of an automobile used largely in the business, and $400 for a second car purchased in September, 1941. Title to both cars were taken in their joint names. She also used over $1,500 of her separate funds for living expenses after marriage and she paid medical bills of $225. After the birth of their first child in September, 1941, she changed her separate account into a joint account of herself and husband for convenience. This account was closed by a withdrawal of $1,669 in October, 1945. (R. 117.)

The corporation reported a loss of $8,937.39 for

the fiscal year ended September 30, 1943, and it lost about $22,000 during the period between October, 1942, and April, 1943, on account of numerous rejections of products and the retooling of equipment for performance of new contracts. But the business again prospered after the partnership took it over and adopted some managerial changes. The partnership's income tax return filed for the period April 1-December 31, 1943, disclosed net profits of $152,760.70, later reduced, however, by $50,000 after the renegotiation of war contracts. The taxpayer and his mother[1] were each credited with 40 percent, or $61,104.28, and the taxpayer's wife with 20 percent, or $30,552.14. Each reported his respective share on an individual income and victory tax return. The taxpayer and his wife withdrew $28,400 and $14,200, respectively, of the shares credited to them, and each deposited the amount withdrawn in their joint bank account. The deposits were used for the payment of living expenses and income taxes and a large balance remained. (R. 117-118.)

For the year 1944 the partnership reported net profits of $114,855.19, of which $45,942.08 was credited to the taxpayer; a like amount to his mother, and $22,971.03 to his wife. Each reported his respective share on an individual income tax return. The taxpayer and his wife made withdrawals of $54,800 and $21,900, respectively, which

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[1] The word "brother" is erroneously used instead of "mother" in the Tax Court's findings of fact. (R. 117.)

they deposited in their joint bank account. During 1944 they used funds from the account to pay living expenses and income taxes, and invested about $20,000 in two single premium policies of insurance on the taxpayer's life, the wife being named beneficiary. They withdrew $10,000 and placed it in a safe deposit box to which each had access. The taxpayer's wife spent $1,800 on a trip for health purposes and $600 for jewelry. A large balance remained on deposit. The taxpayer's wife had a separate savings account, but did not deposit any funds withdrawn from the partnership in it. (R. 118.)

In determining the taxpayer's income and victory tax for 1943 the Commissioner recomputed partnership profits by eliminating $50,000 refunded after renegotiation of the war contracts, and included 60 percent of such profits in the taxpayer's taxable income, reflecting the addition of the 20 percent share, as adjusted, reported by his wife. In determining the taxpayer's income tax for 1944, the Commissioner added to income the $22,971.03 partnership profits reported by the taxpayer's wife. (R. 119.)

On these facts the Tax Court held that no bona fide partnership existed between taxpayer and his wife during the taxable years in question. (R. 119-124.) The Court of Appeals affirmed *per curiam*. (R. 131.)

ARGUMENT

Petitioner's main contention here is that the court below erred in refusing to remand the case to the Tax Court with directions to reconsider it in the light of the decision of this Court in *Commissioner* v. *Culbertson,* 337 U. S. 733. In the latter case such a remand was ordered because the Tax Court had failed to give consideration to all the factors relevant to a determination of the actual intent of the parties. This Court found in that case that the Tax Court had erroneously applied the criteria established in *Commissioner* v. *Tower,* 327 U. S. 280, and *Lusthaus* v. *Commissioner,* 327 U. S. 293. While it is true that the Tax Court in the present case did not have the benefit of the *Culbertson* opinion to guide it in its determination, the record clearly shows that it gave consideration to all of the factors relied upon by taxpayer to establish the existence of a bona fide partnership relation between himself and his wife, and that it reached its conclusion by a proper application of the tests approved in the *Culbertson* case. Since the undisputed facts support the Tax Court's conclusion that the parties did not in good faith and acting with a business purpose intend to form a bona fide business partnership, the Court of Appeals was amply justified in affirming the decision of the Tax Court without remanding it for reconsideration in the light of *Culbertson.* The record shows that the only services contributed by taxpayer's wife to her hus-

band's business were performed during the years 1938-1940 and consisted merely of helping out clerically during the weekends and some evenings; and her only capital expenditures over this period were for personal and family purposes. (R. 113, 117.) And although the taxpayer's wife alleged that she obtained a proprietary interest in the partnership from her mother-in-law in 1939, in consideration of these contributions, it is significant that no recital of such an interest was contained in any articles of partnership prior to the partnership in question which was formed in 1943 on advice of tax counsel. (R. 113-114, 115, 121.) The wife's only contribution to this partnership was a note in the amount of $1,335.45 which was discharged by a check drawn upon a joint account in the names of taxpayer and his wife. (R. 117.) Furthermore, taxpayer's wife never exercised any powers of management and control over the partnership business; rather, the taxpayer retained and exercised all the powers he had enjoyed prior to the partnership's formation. It is true that taxpayer's wife did discuss business matters with taxpayer at home and encourage him in his undertakings (R. 117), but this was not shown to be more than a normal incident of their marital relationship. And with respect to her distributive share of the partnership income, the record discloses that she deposited it in the joint account of her husband and herself and expended it, if at all, for living expenses, income taxes, activities of family concern and the usual

things a husband procures for his wife, although she maintained a separate savings account in which some of her partnership income could have been deposited. (R. 118.)

Although none of these factors, considered alone, might compel the conclusion reached by the Tax Court, it is clear that, taken as an integrated whole, as the Tax Court did (R. 119-124), they justified the determination that this was not a situation where "the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise." *Commissioner* v. *Culbertson,* 337 U. S. 733, 742.

CONCLUSION

The ruling below is correct, and there is no conflict of decisions. The petition for certiorari should be denied.

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SEPTEMBER 1950.

☆ U. S. GOVERNMENT PRINTING OFFICE 1950 908069 151

FILED
OCT 11 1950
CHARLES ELMORE GROPL
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In the

Supreme Court of the United States

OCTOBER TERM, 1950

No. 262

CHARLES A. CAROLIN,
Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE,
Respondent

PETITIONER'S REPLY BRIEF

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SUBJECT INDEX

	Page
Argument	1-6
Conclusion	7

INDEX TO AUTHORITIES CITED

Arnold, H. E., Collector v. Julius Schepps, (C. A. 5th) 166 Fed. (2) 821	5
Calcaterra, Joseph v. Commissioner, 7 T. C. M. 803	6
Canfield, Claire L. v. Commissioner, (C. A. 6th) 48-2 U. S. T. C. 9337	6
Commissioner v. Culbertson, 337 U. S. 733	2, 3, 7
Greenberger, Milton v. Commissioner (C. A. 7th), 49-2 U. S. T. C. 9454	5
Haber, Leon v. Commissioner, 8 T. C. M. 996	6
Kusmick, Paul L. v. Commissioner, 11 T. C. 288	5
Lawton, Howard B. v. Commissioner, (C. A. 6th) 164 F. (2) 380	6
Miller, Sam H. v. Commissioner, (C. A. 6th), 50-1 U. S. T. C. 9327	3, 5, 7
Poling, Harry L. v. Commissioner, 7 T. C. M. 619	5
Wenig v. Commissioner (C. A. D. C.), 49-2 U. S. T. C. 9348	5

nor the language on page 13—"Since the undisputed facts support the Tax Court's conclusion that the parties did not in good faith and acting with a business purpose intend to form a *bona fide* business partnership * * *". The only language in the entire decision of the Tax Court on this point are these words, "We sustain respondent's determination that the wife should not be recognized as a partner for *tax purposes*" (Italics supplied), (R. 123). Nowhere in respondent's determination is there a finding that petitioner and his wife were not acting in good faith with intent to join together as partners (R. 6-10). To paraphrase the words of this Court in the *Culbertson* case (P. 743) "Not once in its (Tax Court) opinion is there even an oblique reference to any lack of intent on the part of petitioner and his wife to combine their capital and services for the purpose of carrying on the business." The most that can be said of the Tax Court decision is that it held the services of Helen E. Carolin were not "vital" and her capital contribution did not "originate" with her, therefore, for tax purposes, she should not be recognized as a partner. This Court took great pains in the *Culbertson* case to point out that the determination of the existence of a partnership is no different for tax purposes than for other purposes.[1]

Respondent argues, after reiterating the Tax Court's findings of fact, that those findings of fact justify a determination that this was not a situation where "the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enter-

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[1] Mr. Justice Frankfurter stated (P. 750), "The final sentence of the portion quoted [from Tower case] underlines the fact that the Court did not purport to announce a special concept of 'partnership' for tax purposes differing from the concept that rules in ordinary commercial-law cases".

prise." That contention is not well founded. As pointed out in our original brief, it is for the Tax Court not the Court of Appeals to ascertain the existence of the partnership. On pages 11 to 12 of our original brief we discussed the *Sam H. Miller v. Commissioner* case decided by the Court of Appeals below. In that case respondent similarly argued that the conclusion of the Tax Court in denying the partnership was correct even though the Court had not expressly found as to intent. The Court of Appeals below conceding the persuasiveness of respondent's contention nonetheless held that in the absence of such findings by the Tax Court the case must be remanded to the Tax Court under the *Culbertson* case. Respondent is not seeking certiorari in that case. Furthermore, the Tax Court did not consider *all* the facts in the case which bore on the intent of the parties. There were six instances of material and uncontroverted testimony in the record which bore upon the intentions of the parties to which the Tax Court made no reference in its Findings of Fact. The Tax Court was concerned with finding only as to "vital services" and "original capital" in arriving at its determination of the issue in the case. The testimony not found in the Tax Court's findings are:

(a) That in the spring of 1938, an agreement was entered into between Helen E. Carolin and her future mother-in-law, Louise W. Carolin, whereby Helen E. Carolin would continue working to help support herself and petitioner so that he could stay with the foundry, provided, however, the brothers and sisters signed off their interest in the foundry and that the business would then be between her, petitioner and his mother. That the mother agreed to give petitioner and Helen E. Carolin a partnership in the business when the brothers and sisters did sign off (R. 66, 30).

(b) That petitioner and Helen E. Carolin believed she was a partner even though not named as a partner in the first partnership agreement of July 29, 1939 (R. 84, 89).

(c) That Helen E. Carolin's cash advances and personal services added to the success of the business and that petitioner could not have stayed on in the business without her help (R. 42, 81).

(d) That when the business was incorporated October 1, 1941, petitioner had certificate #1 for 4500 shares issued in the joint names of himself and Helen E. Carolin in recognition of her prior interest in the business (R. 40, 72, 89).

(e) That the reason and purpose for the formation of the partnership in question April 1, 1943 was to comply with the wishes and insistence of petitioner's mother, Louise W. Carolin because incorporation of the business had resulted in the disallowance to her of the percentage rental under the lease as well as salary paid her by the corporation (R. 47).

(f) That the only reason the corporation was not dissolved at the time of the formation of the partnership in question was that by the retention of the underlying lease to the business property in the corporation, petitioner and his wife would be protected from the claims of brothers and sisters upon the death of his mother since they could at that time revert to the corporate form of business in which petitioner and his wife held the majority stock (R. 47).

The fact that Helen E. Carolin contributed services to the business only through 1940 does not detract from the intention of the parties that Helen E. Carolin be a partner in the agreement of April 1, 1943 as respondent argues. The record is clear that Helen E. Carolin continued working at the foundry till the spring of 1941. In the spring of

1941 she was expecting a child which was born November 6, 1941. During pregnancy and for a period after the birth of the child it was not expected that Helen E. Carolin could render services to the partnership formed April 1, 1943. The following year 1944, Helen E. Carolin was quite ill due to tuberculosis (R. 50). These facts likewise are absent from the Tax Court's findings of fact. So it may be seen that for the period from 1941 to 1944 Helen E. Carolin could not perform services. The business did, however, have the benefit of her services in its formative stages. Where the wife could not or was not expected to perform services the courts have recognized her partner status, *Harry L. Poling v. Commissioner,* 7 T. C. M. 619; *Paul L. Kusmick v. Commissioner,* 11 T. C. 288; *H. E. Arnold, Collector v. Julius Schepps,* (C. A. 5th) 166 Fed. (2) 821; *Milton Greenberger v. Commissioner* (C. A. 7th) 49-2 U. S. T. C. 9454.

Respondent discounts Helen E. Carolin's claimed interest in the business derived from her mother-in-law in 1938 because no recital of such interest was made until 1943. Respondent overlooks the uncontroverted testimony that petitioner and his wife believed she was a partner though not named as such in the first agreement of July 29, 1939 (P. 84, 89) and that as early as October 1, 1941, her interest was formally recognized when the stock in the new corporation was made in her name and petitioner's (R. 40, 72, 89).

Respondent minimizes the services rendered by Helen E. Carolin as "a normal incident of their marital relationship". This reasoning is outmoded as legitimate rationale, *Wenig v. Commissioner* (C. A. D. C.) 49-2 U. S. T. C. 9348, *Sam H. Miller v. Commissioner, supra.* The importance of one's services to the business is not lessened

by virtue of the fact that she may be the wife of one of the partners.

Counsel for respondent is in error when he argues that Helen E. Carolin deposited all of her distributive share of the partnership profits in the joint bank account. Helen E. Carolin retained in the business $17,687.59 out of her share of the profits for 1943 and at the end of 1944 there still remained in the business to her account $18,758.62 (Exhibit 32). She had complete control of her retained earnings in the business and they were not at the command of petitioner. The monies that were withdrawn were used principally to pay income taxes and invest in the two single premium policies of insurance on taxpayer's life in which Helen E. Carolin was named the beneficiary. The Tax Court in a recent decision, *Leon Haber v. Commissioner,* 8 T. C. M. 996, in discussing control of business income by the wife of the taxpayer under facts similar to the case at bar stated:

> "While the wife may not have individually withdrawn and spent all of her derivative portion of the partnership income during the years involved, its use in the business in a large sense owned and controlled by her, inured to her benefit and was necessarily reflected in her capital or drawing account, * * *."

The manner in which petitioner and his wife handled their withdrawals is not inconsistent with a *bona fide* intention to join together as partners.[1]

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[1] *Claire L. Canfield v. Commissioner* (C. A. 6th), 48-2 U. S. T. C. 9337, in which husband and wife from their joint withdrawals paid their respective income taxes, the mortgage on their home, furnishings and war bonds, the surplus kept in liquid form in a joint safe deposit box; *Joseph Calcaterra v. Commissioner,* 7 T. C. M. 803 in which the petitioner and his wife had joint bank accounts which were used for both business and living expenses, and that in the *Howard B. Lawton v. Commissioner* (C. A. 6th), 164 F. (2) 380, the parties had a joint bank account out of which Mrs. Lawton paid the household expenses.

CONCLUSION

Respondent has failed to show wherein the decision of the Tax Court and the Court of Appeals below is not in conflict with the decision of this Court in the *Culbertson* case. He has not shown that the decision of the Court of Appeals below is not in conflict with the decisions of the Fifth and Ninth Circuits. He contends the decision of the Court of Appeals may be sustained below on the sole premise that the Tax Court could have come to the same conclusion with due regard to the *Culbertson* opinion. The Fifth and Ninth Circuits and now the Court of Appeals below in the *Sam H. Miller* case hold to the contrary. Definitely a conflict of decisions exists which can only be resolved by the allowance of the writ prayed for.

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